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/DCI

NSC Meeting

President Mitterrand's Visit

13 March 1984

2:00

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SA/DCI/IA

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NSC Meeting on President Mitterrand's Visit

13 March 1984

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12 March 1984

MEMORANDUM FOR: Director of Central Intelligence

FROM: SA/DCI/IA

SUBJECT: NSC Meeting on President Mitterrand's Visit,  
13 March 1984

1. You are scheduled to attend an NSC meeting on Tuesday, 13 March at 2:00 p.m. in the Cabinet Room. The subject of this meeting will be the visit of French President Mitterrand to Washington. This session had originally been scheduled for last Friday. This will be a principal plus one meeting and will be chaired by the President. (Milt Kovner will be accompanying you.) You are not scheduled to provide a briefing.

2. At Tab A you will find the agenda for this meeting; it includes two papers, both drafted by State Department. The first paper describes the initiatives that might be undertaken during the French President's visit, while the second paper lists the objectives that we should be seeking to further during his visit.

-- At tab B is an analysis that I have asked DDI/EURA to prepare that covers most of the major elements of the two papers.

At Tab C are recent publications--intelligence assessments or typescript memos that are relevant to the issues to be discussed. At Tab D are recent NIDs and PDB that may be of interest. Finally, at Tab E is a typescript memo on recent French attempts to further coordination of European defense policies. This memo treats, in particular, the West European Union (WEU) initiative.

3. Please let me know if there is anything else you need for this meeting.

cc: DDCI

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## MEMORANDUM

## NATIONAL SECURITY COUNCIL

VIA LDX

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March 9, 1984

Executive Registry

84- 1115/1

## MEMORANDUM FOR:

MR. DONALD GREGG  
Assistant to the Vice President  
for National Security Affairs

MR. THOMAS CORMACK  
Executive Secretary  
Central Intelligence Agency

MR. CHARLES HILL  
Executive Secretary  
Department of State

AMBASSADOR HARVEY FELDMAN  
Washington Representative for  
Ambassador Jeane Kirkpatrick  
Department of State

MR. CHRISTOPHER HICKS  
Executive Secretary  
Department of the Treasury

MR. DENNIS WHITFIELD  
Executive Assistant to the  
United States Trade Representative

COL (P) JOHN STANFORD  
Executive Secretary  
Department of Defense

BRIG GENERAL GEORGE JOULWAN  
Executive Assistant to the Chairman  
Joint Chiefs of Staff

MS. HELEN ROBBINS  
Executive Assistant to the Secretary  
Department of Commerce

MR. KENNETH PEDERSEN  
Director of International Affairs  
National Aeronautics & Space  
Administration

MR. RAYMOND LETT  
Executive Assistant to the Secretary  
Department of Agriculture

MS. TERESA COLLINS  
Chief, Secretariat Staff  
United States Information Agency

MR. ALTON KEEL  
Associate Director, National Security  
& International Affairs  
Office of Management and Budget

SUBJECT: National Security Council Meeting - Mitterrand Visit (C)

We have rescheduled the National Security Council meeting on the visit of French President Francois Mitterrand to Washington for Tuesday, March 13, 1984, at 2:00 p.m. The agenda for the meeting and the two State discussion papers provided earlier are still in effect. Please provide additional suggestions for discussion and names of attendees (principals plus one) by 10:00, Monday, March 12. (C)

*Robert M. Kimmitt*  
Robert M. Kimmitt  
Executive Secretary

DCI  
EXEC  
REG

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**NATIONAL SECURITY COUNCIL MEETING**

**Friday, March 9, 1984  
11:00 a.m. - 12:00 Noon  
Cabinet Room**

**AGENDA**

**Introduction (5 minutes) . . . . . Robert McFarlane**  
**Themes and Objectives (10 minutes) . . . . . George Shultz**  
**Security Issues (5 minutes) . . . . . Caspar Weinberger**  
**Economic Issues (5 minutes) . . . . . Donald Regan**  
**Discussion (30 minutes) . . . . . Principals**  
**Conclusion (5 minutes) . . . . . Robert McFarlane**

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Washington, D.C. 20520

February 29, 1984

**SECRET****MEMORANDUM FOR MR. ROBERT C. MCFARLANE  
THE WHITE HOUSE****Subject: State Visit of the President of France: Themes and  
Policy Initiatives**

In connection with French President Francois Mitterrand's March 22 state visit, the Department, in conjunction with other agencies, has been considering a series of themes, events or policy initiatives designed to enhance the visit and help ensure its success. Described below is a group of such ideas, one of which has already been approved by the NSC. The Department would appreciate early NSC authorization to discuss these items with the French Government, both here and in Paris.

1. "Liberty Initiative". Work is well underway leading to the 1986 celebration of the centennial of the Statue of Liberty. It would be appropriate to use the Statue as a symbol of our shared love of liberty and of the friendship between the two oldest democracies, the U.S. and France. Building on this theme, references could be made to the Statue and its symbolism in public statements by the two Presidents, including in the President's toasts. We could also encourage the French to arrange for Mitterrand to visit the Statue of Liberty while he is in New York. Tied in with this, we also propose that the President offer to send the Constitution and/or Bill of Rights to France for exhibition during their 1989 bicentennial celebration of the French Revolution. The Bill of Rights would be particularly appropriate since it was based on France's Declaration of the Rights of Man. Mitterrand -- and the French people generally -- would see this as a truly significant gesture on the part of the President. USIA concurs in this and is providing a parallel recommendation. If this proposal is approved, we would like White House assistance in obtaining agreement to lend the document(s).

2. Space Cooperation. The Department and NASA have already received NSC authorization for NASA Administrator Beggs to discuss the elements of a space cooperation package with appropriate French officials during his March 8-9 visit to Paris.

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3. Environmental Affairs Umbrella Agreement. EPA has proposed to the French a Memorandum of Understanding on environmental cooperation. French Government review of the text is going extremely well. With appropriate encouragement from us, the French would probably be ready to sign the agreement during the visit, perhaps at the level of EPA Administrator Ruckelshaus and French Ambassador Vernier-Pallier.

4. African Development Initiative. Both we and the French are deeply concerned about Africa's economic crisis. The French have traditionally provided major economic assistance to the region, particularly to their former colonies. For our part, the Administration has recently announced an African Economic Policy Initiative (EPI) and requested \$500 million over five years, additional to our current \$1 billion per year program. The French have not yet responded to Secretary Shultz's January 25 letter describing the EPI and the French are leery of joint activities in which they might appear to be the junior partner. However, French (and EC) policy would appear to be fully in line with the goals of the EPI. Our two governments have begun active -- if quiet -- aid cooperation in Senegal, the Ivory Coast and elsewhere. The Department believes it would be most appropriate during the visit to have a joint public statement noting that: a) the Presidents reviewed the economic crisis in sub-Saharan Africa; b) they exchanged views on efforts by both governments to provide both emergency food and other aid to drought victims; and c) they looked forward to further mutual cooperation in devising economic assistance programs which would restore stability and growth for Africa. In this connection, we would also plan to encourage the French to have Mitterrand make a statement of French interest and support for the EPI, pointing out how this would help us with Congress. If this initiative is successful, we should then see if similar agreements can be reached with the other Summit countries, with a view to having language in the London Summit communique on this issue and on the need for EPI-like measures.

5. Cooperation Against Terrorism. There have been encouraging signs in the past few months of increased French awareness of the terrorist threat they face, accompanied by an apparent new willingness to act. It is unlikely that they would agree to any joint public statements, but we may be able to get French agreement to move ahead on some quiet steps, such as: a) initiation of carefully organized bilateral discussions on the increased threat both countries face on terrorism; b) informal agreement to intensify the already imposing bilateral cooperation on counter-terrorism at the operational and technical levels; and c) most difficult, attempt to develop an understanding on clearer lines between the right of

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legitimate asylum and violations of same by the use of France or other countries for terrorist operations. There are considerable differences within the French Government on the terrorism issue, generally, and cooperation with the U.S., specifically. To achieve success, we would have to move rapidly with our potential allies, such as Defense Minister Hernu and State Secretary of Security Franceschi. Secretary Shultz made the first proposal to Hernu on February 24 and Hernu was interested and supportive. Franceschi will be here March 2-6 and, if we have NSC approval, the Department and other agencies will propose these items to him. Once we are authorized, we also intend to instruct Embassy Paris to move ahead, understanding that the degree of assurance of French concurrence is less than other proposals outlined here.

6. Bilateral Cultural Talks. USIA Director Wick has been exploring with the French the idea of holding bilateral meetings on a broad range of cultural and exchange issues. Embassy Paris is currently discussing with the French their willingness to begin such discussions. If they agree, it would be appropriate to announce it at the time of the visit. USIA will be providing the NSC with more background.

*Brockmeyer*  
for Charles Hill  
Executive Secretary

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ISSUES AND OBJECTIVES FOR THE STATE VISIT OF THE  
PRESIDENT OF FRANCE

1. Issue: Western security, the Alliance and arms control.

Objective: To underline publicly and privately our close identity of views on security issues; emphasizing the strength of trans-Atlantic ties and our common desire to move forward on arms control with the USSR.

Mitterrand has been a potent champion of trans-Atlantic security cooperation and of Western firmness in arms control negotiations. The French see Alliance unity and the continued viability of the U.S. nuclear umbrella to be essential to countering a German drift toward neutralism. Mitterrand will want this visit to symbolize the themes he has struck repeatedly in public statements -- Alliance strength and U.S.-European common interests in defense of Europe. The discussions with the President should provide substance to underline these themes. In the context of the Kremlin leadership transition, we should be able to agree on a call for intensified East-West dialogue, a Soviet return to the nuclear arms talks and establishment of a more stable relationship with the USSR. On INF, they can agree on continued deployment in the absence of an agreement. The President should also lay down markers for the London Summit, stressing our interest in forming new partnerships for cooperation in the space station and in combatting terrorism.

2. Issue: Regional cooperation (Lebanon, Gulf, Chad).

Objective: To encourage continued close U.S.-French cooperation on regional issues.

More than any other ally, France has asserted a set of global interests which brings it into play on most regional issues of importance to the U.S. Our political-military cooperation has been particularly close in recent years in Lebanon and Chad, while we have pursued largely parallel policies in the Gulf. The French value this cooperation, even while wishing publicly to avoid any implication of loss of treasured French independence. Mitterrand will welcome an expression of our appreciation for the constructive French role in the Middle East and Africa. We should stress our hope that France will avoid independent actions detrimental to the President's Middle East peace initiative, along with our opposition to a wider Soviet role in the region. A common statement of concern about any restriction of Persian Gulf shipping could send a useful public signal.

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### 3. Issue: U.S.-European relations.

Objective: To reiterate our support for an economically strong Europe, while cautioning against protectionist actions harmful to trans-Atlantic relations.

With France in the EC Presidency, U.S.-European economic problems will be very much on Mitterrand's mind. Just prior to coming to Washington, he will have chaired an EC Summit and will undoubtedly feel empowered to speak for Europe. He may criticize US monetary and fiscal policies; he may also advance the idea that the U.S. should help Europe solve its problems by accepting limits on certain U.S. agricultural exports (corn, gluten, soybeans). We should reemphasize our support for European unity, but frankly warn against reborn European protectionism. Containing protectionist pressures is an obligation Europe and America share. In recognition of the economic difficulties Europe faces, we may wish to suggest joint discussions of how to put technology to the service of economic growth.

### 4. Issue: Bilateral U.S.-French Relations.

Objective: To strengthen the bilateral relationship.

The fact that both our countries have global interests often complicates our bilateral relationship. Nonetheless, our two countries have a long history of friendship and a shared commitment to democracy and liberty. Mitterrand's advisors have articulated objectives for this visit quite similar to ours: to celebrate U.S.-French friendship; to strengthen personal relations between the two Presidents; and to give the relationship a forward-looking focus. To this end we are developing a package of specific initiatives, for example, in space cooperation, to stress the commonality of our efforts for the future. We should also emphasize in our public statements our mutually shared commitment to democracy and liberty. The Statue of Liberty centennial provides a reference point to highlight U.S.-French friendship.

### 5. Issue: Our policy toward Central America.

Objective: To solicit some increased understanding for our Central America policy.

This is the area of clearest policy divergency between us. The elections in El Salvador, coming in the middle of the Mitterrand visit, will heighten interest in this issue. The French value their self-appointed role as an interlocutor between the Central American/Caribbean left and the U.S. While we cannot change their mind, continued private dialogue may help contain any French impulse to oppose us publicly.

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SECRET [REDACTED]

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DCI Talking Points: NSC Meeting - Mitterrand VisitIntroduction

We believe President Mitterrand will be seeking a public demonstration of solid French-US relations as well as substantive discussions on major international issues. Mitterrand sees no contradiction between France's strong -- and increasingly visible -- support for the Atlantic Alliance and its insistence on respect for French "independence," and he will avoid statements that could appear to compromise French freedom of action. Although Mitterrand almost certainly will not seek to be contentious and agrees with Washington on larger security, economic, and political interests, there is a possibility of some disagreement -- even in public -- on specific issues and tactics. One of Mitterrand's principal concerns will be to improve France's image in US financial and business circles, stressing its new emphasis on technological innovation in electronics, transportation, and nuclear energy.

[REDACTED] 25X1

Space Cooperation

At the end of February Mitterrand responded favorably to President Reagan's proposal for cooperation on a civilian space station. The French probably hope that cooperation with the United States will provide them with technology that would be valuable for a later European project.

- In a speech at The Hague early in February, Mitterrand called for the development of a joint European space station as part of their future defense plans. [REDACTED]

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Western Security, the Alliance, and Arms Control

The French think the West should not make concessions on arms control issues just to get the Soviets back to the bargaining table.

- French policy is that their missiles should not be included in arms control talks until the superpowers make major cutbacks.
- Mitterrand sees his current initiative to revive the Western European Union as a means of enhancing the Europeans' own defense, tying West Germany more closely to the Alliance and strengthening Europe's collective voice on Allied defense issues. [REDACTED]

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Regional Cooperation

On Chad, the French probably will encourage expanded US military and economic assistance to the Habre government, short of increasing President Habre's ability to launch operations north of the French defensive lines. We

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SECRET [REDACTED]

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believe Mitterrand's resolve to resist Libyan pressures remains strong, but he does not want to close the door on negotiations with Qadhafi.

- He will want to avoid any public indication that Paris and Washington are coordinating policies regarding Libya.
- Mitterrand might want to sound out US officials on prospects for a settlement in Namibia, where the French publicly have opposed explicitly linking a Cuban troop withdrawal from Angola to a Namibian settlement.
- Mitterrand, however, probably is willing to work privately with the United States to reach a compromise among the interested parties. [REDACTED]

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- Mitterrand probably believes that France is better situated than the United States to encourage moderation within the Arab world -- including the Palestinians.
- He may still hope that Paris can gain some measure of Soviet acquiescence in an overall settlement. [REDACTED]

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The French have a considerable political and commercial stake in Iraq, and they do not want to see it defeated in its war with Iran. They believe French ties with Iraq have helped to lessen Iraq's dependence on the Soviets as well as to help protect moderate Arab regimes elsewhere in the region from the spread of Iranian-style extremism.

- At the same time, the French probably would be very nervous about any public suggestion that French and US forces might operate jointly in the Persian Gulf, particularly since French interests continue to be threatened by Iranian terrorist attacks.
- They might prefer a more general statement calling for a cessation of hostilities in the region. [REDACTED]

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#### US-European Relations

Mitterrand, speaking for France and perhaps the EC, may raise the issues of greater exchange rate stability and increased aid flows to the LDCs. [REDACTED]

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Mitterrand is pleased with the recent settlement within GATT between the United States and the EC concerning compensation for US steel protectionism and by the International Trade Commission's determination favorable to the French denying the US wine industry's demands for protection against wine imports.

- Nonetheless, Mitterrand may seek further assurances from the President that the US Administration will actively oppose American protectionist pressures. [REDACTED]

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SECRET [REDACTED]

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SECRET [REDACTED]

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Mitterrand would like to use this trip to improve America's image of France and to advertise Socialist efforts to modernize industry.

- Any joint high technology initiatives will be well received.
- Nonetheless, we believe that EC technological cooperation is a priority for the French that will not be sacrificed unless the US offers an extremely attractive substitute package. [REDACTED]

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### Central America

Although Paris remains critical of US policies in the region, its sympathy for the Sandinistas and Salvadoran rebels has waned considerably over the past year. We have seen no indications that the French are prepared to discuss any new arms sale to the Nicaraguans. [REDACTED]

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### African Development Initiative

The Mitterrand government has been considerably more interested than its predecessors in cooperation with the United States on African issues, but Paris continues to have a strong preference for a case-by-case approach. Some French officials have lingering suspicions that the United States might try to increase its influence in Africa at French expense. They also worry that close identification with US policies could damage their credibility as an "alternative to the superpowers" in Africa -- an image that they hope will help to wean "progressive" regimes from Soviet, Cuban, and Libyan influence. We believe that the French would welcome a joint public statement on African economic problems.

- Mitterrand might want to broaden the scope of such a statement to emphasize the role of international agencies such as the World Bank, International Development Agency and IMF.
- Paris might then be able to claim, in discussions with African leaders, that Mitterrand had successfully influenced US thinking on this score. [REDACTED]

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### Cooperation Against Terrorism

The French appear to be more willing to act against terrorism now that France itself is becoming a central arena of terrorist activity. They have, for example, taken some steps to control the activities of Spanish Basque terrorists who have used France as a refuge. Nevertheless, the French tradition of granting political asylum to "political exiles" continues to enjoy strong political support.

- Mitterrand therefore will probably continue to avoid making a strong commitment on this issue. [REDACTED]

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SECRET [REDACTED]

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# Mitterrand's Economic Management: Have the Lessons Been Learned?

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An Intelligence Assessment

This paper was prepared by [redacted]  
Office of European Analysis. Comments and queries  
are welcome and may be directed to the Chief,  
Western Europe Division, EURA [redacted]

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EUR 83-10277  
December 1983

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### Mitterrand's Economic Management: Have the Lessons Been Learned?

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#### Key Judgments

*Information available  
as of 1 December 1983  
was used in this report.*

The biases and miscalculations of the Socialist-Communist government formed under President Francois Mitterrand in 1981 aggravated an already bad economic situation. The government:

- Worsened a serious deficit with a strongly expansionary budget.
- Enacted a costly nationalization program.
- Instituted tax and labor measures that shook the confidence of management.

The program was a failure, marked by continuing high inflation, mounting trade and payments deficits, and three successive devaluations of the franc.

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Faced with serious economic problems, Mitterrand chose the classic economic remedies—reducing domestic liquidity and slowing economic activity—recommended by his principal economic advisors over the more radical solutions advocated by his Communist coalition partners and the left wing of his own party. The left wing urged:

- High-growth and jobs-oriented policies.
- Tighter controls on prices, wages, and capital movements.
- Protectionist barriers against foreign competition.
- Withdrawal from the European Monetary System, considered to represent the subordination of national goals to international commitments.

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Austerity measures introduced in June 1982 and tightened significantly in March 1983 have brought the policies of the French Government into line with those of its major Western partners. They provide for:

- Reduced household consumption through higher taxes and a forced loan to the state.
- Slower growth in government and public-sector outlays.
- Lower monetary growth targets.

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Mitterrand's turn toward austerity has been politically costly. The coalition parties have lost a series of local elections and have declined in public opinion polls. The evidence indicates that the government has lost support from both leftists and the moderates whose backing was responsible for Mitterrand's margin of victory in 1981.

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Pressure for an easing of the austerity program is likely to mount in coming months as workers resist further reductions in their real wages. We believe, however, that the government is likely to stand firm at least for the next 12 to 18 months:

- It has made substantial progress in reducing the trade deficit, and it is likely to have at least modest success in lowering the rate of inflation.
- Trade unions and workers will be reluctant to bring down a leftist government.
- The Socialists command a majority in the National Assembly and do not face new elections until 1986, while Mitterrand's term runs to 1988.

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Achieving a lasting solution to France's fundamental problems—a growing external debt burden, a chronically weak franc, and lagging industrial competitiveness—will depend on maintaining present policies for a prolonged period.

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We are relatively optimistic on this score, even though the record of French politicians in resisting the siren call of political expediency is not good. We believe that Mitterrand and other senior policymakers have been chastened by their early mistakes and now have an appreciation of the need to continue their present economic program.

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The United States has a strong interest in a stable France and the success of Mitterrand's moderate economic policies. Failure might well lead to:

- Increased influence for the advocates of nationalist and protectionist policies and a weakening of the moderate left.
- The weakening of France's economic ties to its major trading partners.
- A diminished French ability to contribute to the defense of the West.

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## Mitterrand's Economic Management: Have the Lessons Been Learned?

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### A Vision of Limitless Horizons

The presidential election in May 1981 brought the French left into government for the first time since the establishment of the Fifth Republic in 1958. Francois Mitterrand's victory over incumbent centrist President Giscard d'Estaing generated near-delirious optimism among supporters of the Socialist-Communist electoral coalition. The magnitude of the victory appeared even greater in June when the Socialists won an absolute majority in the National Assembly, giving the new government (with four Communist ministers out of 44) the political strength to transform Mitterrand's ambitious campaign platform into reality.

In many ways the leaders of the left were ill prepared for power. Few of them had had governmental experience at the policymaking level. They were encumbered by unrealistic ideological prescriptions for France's real and imagined ills, which most of them took quite seriously.

This paper assesses the Mitterrand government's track record to date. After briefly addressing the early profligacy of the Socialist-Communist coalition, it reviews the debate that led to an abrupt change of course and then analyzes the economic and political costs of austerity. Finally, it looks at prospects for economic policy and the economy.

### Early Miscalculations and Their Consequences

By all accounts, the Socialists were convinced that a party that had won office on the basis of a call for "change" would rapidly lose support if it introduced economic and social measures that were only cosmetic. Anxious to avoid this pitfall, they were driven to redeem their promises, but hindsight shows that they failed to appreciate how narrow their maneuvering room was in several critical policy areas. They also unrealistically assessed the impact of external conditions on domestic policy choices. For instance, they assumed that a worldwide recovery was just around the corner and that a stimulus program to boost

### Chronology

May 1981 Mitterrand elected President.

Mauroy appointed Prime Minister.

June 1981 Socialist Party gains absolute majority in National Assembly election.

Prime Minister Mauroy forms coalition government with Communist participation.

October 1981 First devaluation of the franc.

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February 1982 Nationalization bill finally becomes law.

June 1982 Second devaluation of the franc.

"Rigor I"—wage/price freeze in effect.

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October 1982 Freeze lifted at end of month.

March 1983 Heavy Socialist and Communist losses in nationwide municipal elections.

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Third devaluation of the franc.

"Rigor II" — economic austerity.

October 1983 Biennial Socialist Party congress approves Mitterrand's economic policies.

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### *The Economic Inheritance*

*The economic record of the Giscard administration (1974-81) was mixed.* [ ]

*The positive elements afforded the Socialists advantages in several critical areas:*

- *The public-sector accounts had, in general, been prudently managed. Public debt remained roughly stable as a percentage of GDP.*
- *Foreign exchange reserves had been built up substantially by the end of Giscard's term.*
- *Despite the tendency of the current account to fall into deficit as the cost of energy imports soared, the government had been quick to institute adjustment measures.*
- *Although the government resorted to foreign borrowing by public-sector firms both to finance their expansion and to cover balance-of-payments shortfalls, gross guaranteed foreign debt of nearly \$25 billion<sup>a</sup> at the end of 1980, according to the International Monetary Fund, did not present a servicing or repayment problem for the state.* [ ]

*The negative elements left France's industrial structure financially weaker and less competitive:*

<sup>a</sup> At the December 1980 exchange rate of \$1 = FF 4.57. The franc equivalent was 112.9 billion. [ ]

domestic economic growth would not place France too far out of phase with its principal trading partners. Further, they disregarded recent French experience by assuming that a stimulus program would not significantly boost import demand. [ ]

The Socialists' miscalculations led them to worsen an already deteriorating economic situation by:

- *Expanding the serious 1981 budget deficit they inherited and accepting an even larger deficit in a strongly expansionary 1982 budget.*
- *Pushing ahead with a divisive and costly nationalization program.*

• *Unemployment rose steadily.*

• *Mitterrand inherited an inflation rate of 13 percent. Although fighting inflation was an acknowledged priority, the Giscard administration was reluctant to attack it head on by, for example, directly challenging the nearly universal custom of wage indexation.*

• *Giscard made little effort to trim increases in welfare costs, choosing instead to raise taxes and social security contributions.*

• *Giscard allowed much of the additional fiscal burden to be borne by French businesses, with the result that profitability declined and productive investment stagnated.* [ ]

*The economic inheritance also included traditions and structures that Giscard himself found in place in 1974. Among these were:*

- *State involvement in the economy—known as dirigisme—a hallmark of which is the government's tendency to intervene in decisionmaking in search of results it considers desirable.*
- *State ownership or effective control of a number of major industrial firms—the result of two previous waves of nationalization in 1936 and 1945.* [ ]

• *Instituting tax and labor measures that reduced entrepreneurial and managerial incentive and heightened the business community's already strong skepticism of a Socialist government.*

• *Underestimating the difficult financial situation of many French businesses.*

• *Paying insufficient attention to the implications for long-run balance-of-payments equilibrium of the rapid buildup in foreign debt that began with increased trade deficits and efforts to defend the franc.* [ ]

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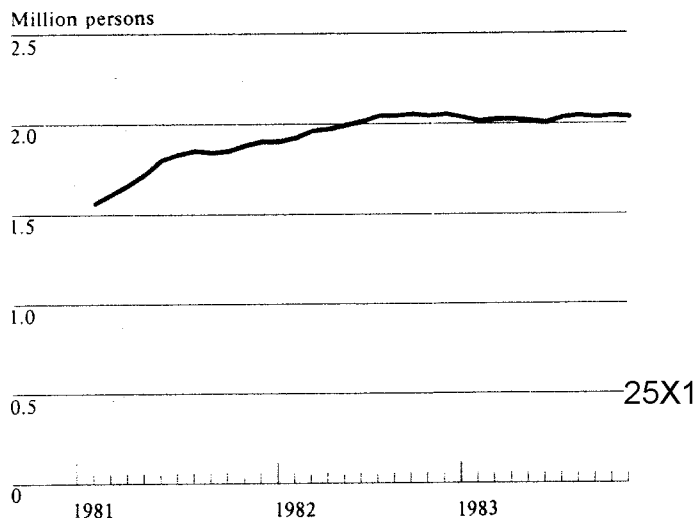
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Contrary to the hopes of the Socialists, the increased purchasing power injected into the economy did not go largely to purchase French goods, thus inducing an investment pickup. French producers were not in a position, for the most part, to supply the durable goods that consumers wanted to buy. Nor were producers able or willing to boost capital spending. Declining profits had already left most of them with diminished cash reserves, and government-mandated increases in costs—including a reduced workweek at full compensation and higher social security charges—unquestionably worsened their situation. In addition, the major industrial firms scheduled for nationalization contributed little to investment, as the lengthy process of enacting the contested nationalization law created a climate of uncertainty in executive offices. Although foreign investment in France did not come to a halt, many foreign firms undoubtedly adopted a wait-and-see attitude about the desirability of new projects. [ ]

The somewhat higher level of domestic activity resulting from the stimulus program contributed to stabilizing unemployment (see figure 1) after mid-1982, but only at the cost of expanded budget deficits that the Treasury could not finance without resorting to greater money creation. Consequently, consumer prices edged upward to an annual rate of about 14 percent during a period when inflation in France's major trading partners was subsiding rapidly. [ ]

In addition to sustaining inflation, the stimulus program was a failure in other respects. Mounting trade deficits, in combination with stagnating receipts in the normally surplus services account and large outward capital movements by French and foreign investors nervous over Socialist intentions, produced massive balance-of-payments deficits during late 1981 and the first half of 1982. External borrowing increased at a rapid rate, occasioned by the need both to cover the shortfall and to defend the franc's parity in the European Monetary System. Foreign confidence in the Mitterrand government plummeted. The decline of the franc provided the most graphic evidence of the failure of Socialist economic policies. Three devaluations followed in rapid succession—in October 1981, in June 1982, and in March 1983. The Socialists were able to attribute some of the responsibility for the first

**Figure 1**  
**France: Unemployment<sup>a</sup>**



<sup>a</sup> Number of registered job seekers at end of month, seasonally adjusted.

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devaluation to the Giscard government, but the next two were unquestionably the product of their own errors. [ ]

### The Policy Debate

The conventional cure for the problems the French franc and the economy experienced after the first year of the Mitterrand government was to reduce domestic liquidity and slow economic activity. The decision to adopt such policy measures, however, posed particular problems for a government of the left. Mitterrand was confronted with a choice between sacrificing elements of his program—such as higher growth levels to reduce unemployment—or risking a weakening of

France's ties with the EC and the world trading system. In the end, he opted for a cautious austerity, which was followed up with bigger doses in later months. [redacted]

### Policy Differences

Most key members of Mitterrand's government believed that it was not practical to try to recreate a more autarchic France and that the ramifications of domestic economic choices on relations with France's principal allies and trading partners should not be disregarded. According to French press accounts, Prime Minister Pierre Mauroy; Finance Minister Jacques Delors; key members of the presidential, prime-ministerial, and Finance Ministry staffs; Bank of France President Renaud de la Geniere; Treasury Director Michel Camdessus; and former Treasury Director and Paribas Bank President Jean-Yves Haberer were among those who warned against changing France's fundamental political and economic orientation. [redacted]

Both Mitterrand's Communist coalition partners and leftist elements within the Socialist Party advocated another course. These proponents of an "alternative" policy pushed for a nationalistic approach featuring higher growth and continued emphasis on reducing unemployment. In keeping with leftist principle and their interventionist inclinations, they believed, according to press reporting and public position papers, that a major role for the state would be necessary to ensure that these priorities were maintained and budget resources made available. They favored tighter controls on prices, wages, and capital movements to minimize the impact of budget deficits and contain inflation. They also favored greater protectionism to shield domestic producers from foreign competition. Finally, they wanted France to drop out of the European Monetary System, which they saw as a symbol of the subordination of national goals to those of other European governments, notably Bonn. [redacted]

The motivations of the Communist and Socialist advocates of an "alternative" course probably differed. The Communist Party (PCF) presumably was

interested in pursuing its long-term goal of detaching France from its ties with Western economic and security organizations, such as the European Community and NATO. In addition, the Communists are little concerned with questions of economic efficiency and have consistently espoused autarchic policies. The approach of the leftwing Socialists, led by then Industry Minister Jean-Pierre Chevenement, was more complicated. They were willing at least to concede the desirability of a European dimension to French policy—as long as it could be on French terms. They argued publicly that the European Community should adopt a policy of faster growth and agree on an arrangement for adjusting EMS parities regularly to take inflation differentials into account. They also advocated "short-term" protectionist measures, such as safeguard clauses, quotas, and orderly marketing agreements. The distinction between them and the openly autarchic Communists was blurred by the Socialist faction's admission that protectionism would be necessary until French industry could once again be fully competitive in world markets. According to press reports, some of Mitterrand's personal advisers—Schlumberger President Jean Riboud, journalist-philosopher-politician Jean-Jacques Servan-Schreiber, and IndoSuez Bank President Georges Plescoff—also argued for strong measures to deal with the trade deficit, proposing the use of protectionist devices available under EC and GATT rules for limited periods of time. [redacted]

### Easing Into Austerity

Although the government began to apply a "conventional" solution with the second devaluation in June 1982, it was still mindful of its commitment to reduce unemployment and was reluctant to slow economic activity too abruptly. Illustrative of the new approach was the replacement in late June of ardent leftist Nicole Questiaux as Minister of National Solidarity (social welfare). Her successor was Pierre Berégovoy, a Mitterrand loyalist who was charged with bringing the social security accounts back into balance by increasing revenues and tightening up on expenditures. Mitterrand also confirmed an earlier injunction that the 1982 and 1983 budget deficits were not to exceed 3 percent of GDP. In addition, the government

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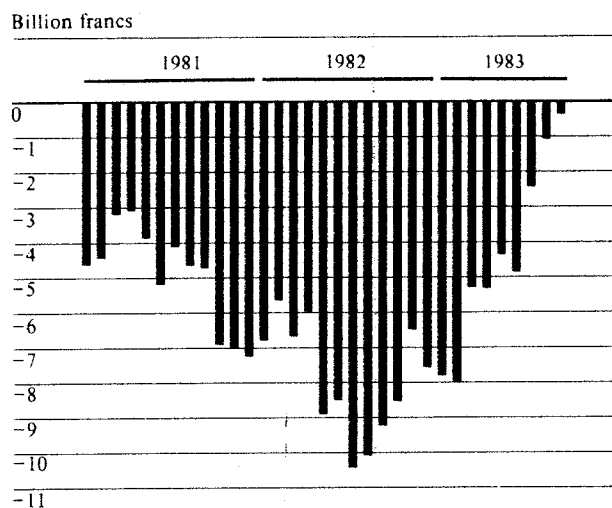
froze most prices and wages for four months in order to bring a quick reduction in the rate of inflation. In an attempt to modify the almost universal practice of indexation, the government elaborated a plan to tie programed wage increases in the public and private sectors to projected rather than actual rates of inflation. The freeze did slow inflation, but improvement in the trade balance was less than had been hoped. This was attributable in part to a sizable increase in real household consumption during the period. Savings were drawn down, and transfer payments offset for many households the effect of the freeze on real wages. [ ]

It took the even greater shock of a third devaluation in March 1983 to persuade the Mitterrand government to produce a program with a good chance of achieving results (see figure 2). New measures put into effect provided for significant reductions in domestic spending by both government and households. The methods used were tax increases, a forced loan to the state, public utility price hikes, an additional tax on petroleum products, and cuts in government and public-sector outlays. In addition, monetary growth targets were lowered, and credit controls were made more restrictive. The intent this time was clearly deflationary. The government recognized that its actions could trigger a recession and would make higher unemployment inevitable; but balancing the external accounts and keeping downward pressure on prices had to come first. [ ]

### The Rationale

There were widespread reports that Mitterrand, who is reputed to have little interest or expertise in economics, was attracted by some of the leftist arguments and was only reluctantly persuaded to go along with Mauroy, Delors, and their supporters. There were compelling political reasons for his choice. First, previous governments of the left in France—notably Leon Blum's Popular Front in the 1930s—had earned a reputation for mismanagement of public finances. We believe that Mitterrand, anxious about his own historical reputation, did not want his name associated with a similar failure. Mitterrand also undoubtedly realized that an economically enfeebled France—the probable consequence of economic isolationism—would find its overall international influence and its ability to pursue its interests diminished. His record

**Figure 2**  
**France: Trade Deficit, 1981-83<sup>a</sup>**



<sup>a</sup> F.o.b.-f.o.b., seasonally adjusted, 3-month moving average.

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suggests, moreover, that Mitterrand also believes a commitment to the European Community and to the world trading system ultimately serves French security interests, as the political isolation that would follow radical economic measures certainly would not. [ ]

There were also sound economic reasons for Mitterrand to decide as he did. If the EMS were abandoned and the franc floated, the drop probably would have been beyond the government's power to reverse. A steep decline in the franc's value, by adding to the cost in francs of imported goods, would have pushed up inflation, countering the government's efforts to reduce it. More fundamentally, import controls to avoid this could only be partially successful, given France's requirement to import nearly all its energy and large quantities of raw materials. Protectionism would also lead inevitably to retaliation against

French exports. In these circumstances, the benefit to the trade deficit would be problematical. In addition, such policies could result in closing foreign markets to the very industrial sectors that the Socialists wanted to develop through the nationalizations and a more vigorous industrial policy. [ ]

### The Impact of Austerity

For the majority of the French, the austerity program's sharpest impact was in terms of declining real income. French workers had experienced steady gains in purchasing power during the period of rapid economic growth that began in 1960, and most of them had come to consider such gains a job perquisite. Moreover, very few would have expected a government of the left to call the "principle" into question. [ ]

The economic shock of austerity rapidly entailed significant political costs. The coalition parties suffered a setback in nationwide municipal elections in March 1983 and since then have endured a series of embarrassing reverses in local elections. Until recently—when public approval of Mitterrand's actions in Lebanon and, to a lesser extent, Chad appear to have reversed the trend—the popularity ratings of Mitterrand and most other Socialist leaders drifted steadily downward in public opinion polls. The evidence is that the shift toward austerity has cost the Mitterrand government support among its own constituency on the left, while failing to win back the crucial support of moderate swing voters disenchanted by the early excesses of the Mitterrand government. As a result, Mitterrand has had to contend with sporadic criticism from the left wing of his own party, an increasingly fractious Communist ally, and manifestations of labor and public unrest. [ ]

Regaining moderate support, which had been slipping even before the change in economic policy, will be difficult for Mitterrand. Many moderates voted against Giscard in the expectation that not much of the Socialist platform would be carried out. For them, Mitterrand's first year—with its prodigality and initiatives such as the nationalization program—was an unpleasant surprise. The austerity program, however, has probably done very little to win them back. Many

of those who opted for Mitterrand are middle class white-collar or middle-management employees. The government's tax-raising measures have hit them hard, and they have not benefited from the breaks accorded lower income workers. The government has also had to confront a rising sentiment among these former supporters that it is fumbling and incompetent. In October, for example, protest demonstrations sponsored by the union that represents many white-collar employees took on an unaccustomed political and antigovernment tone. [ ]

The Socialists have consistently referred to the economic policy now in effect as "rigor" rather than austerity or deflation. This verbal sleight of hand is intended to ward off leftist criticism that the government is pursuing conservative policies and to reassure leftist constituents that fundamental goals, such as reducing unemployment and promoting greater equality, have not been abandoned. This rhetoric has not been persuasive, however, and some longtime leftist voters have become sufficiently disillusioned to stay home on election day or even to vote for opposition candidates. These trends have begun to affect the Socialist Party as much as the previously more vulnerable Communists. They concern Socialist strategists, according to Embassy reporting, even though they do not concede that the voters are irretrievably lost to the left. [ ]

The struggle over the choice between "rigor" and the "alternative" also contributed to a resurgence of Socialist Party factionalism. The dispute broke open after Chevenement's departure from the government in March, when he and his principal lieutenants in the CERES faction<sup>1</sup> began to speak out at party gatherings and in the press. Mitterrand's effort to stay above the battle and avoid committing himself fully and openly to the austerity program suggested a lack of conviction about it and lent credibility to the CERES attack. [ ]

<sup>1</sup> CERES is the French acronym for the Socialist Research and Study Center, the group that claims the allegiance of most members of the party's left wing. [ ]

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Chevenement became less aggressive after Mitterrand began to speak out forcefully in support of austerity, and some local party officials charged that Chevenement's criticism verged on disloyalty. Nonetheless, he submitted his "alternative" as a motion for consideration at the Socialist Party congress in October 1983 and won 18 percent of the overall vote (including a majority in a few federations). In the final voting, a potential embarrassment was avoided when Mitterrand got the unanimity he wanted in exchange for some minor concessions to CERES. [ ]

The existence of dissent on the Socialist left probably encouraged the Communist Party to step up its public criticism of the government's economic policy. Although the PCF has not wanted to bear the onus for breaking the coalition and has gone along with austerity, it has not wanted to be outflanked on its left by CERES and has sought to keep its constituents aware that it prefers the "alternative" policy. Party spokesmen have blamed the decline in the left's popularity on the government's failure to persevere with the expansionist, distributive policies of 1981. In recent months, however, Mitterrand and the Socialists have become increasingly angry over this PCF tactic, which accompanies PCF sniping at the government on foreign policy issues such as INF, Lebanon, and Chad. The disappearance of overt CERES opposition to the government's policies probably will reduce the PCF's maneuvering room, a likelihood the party seems to have grasped early. The PCF has signaled its intention to redirect its attacks toward the opposition and the French Employers' Association, but the harsh tone of recent Socialist criticism of the PCF suggests that Mitterrand and the Socialists are likely to insist on more positive Communist support for austerity in the coming months. [ ]

Opposition political leaders have been relentlessly critical of the government's policies. Given the low priority the French accord civility in political discourse, their criticism has been characteristically harsh, and at times they have implied that a collapse of the government and Mitterrand's early departure from office would hardly be unexpected events. This

tactic was probably useful in rallying party militants discouraged by the leftist landslide of 1981, but it also contributed to a climate of rising social tension and political polarization that, we believe, alienated many thoughtful Frenchmen. Perhaps in response, the scenario of impending chaos has been downplayed recently by opposition leaders, who have shifted their attention to the National Assembly election scheduled for 1986. [ ]

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#### Current Prospects

The Mitterrand government's early excesses and the obvious reluctance of some Socialist leaders to accept the need for "rigor" have raised many questions about the durability of the Socialist commitment to moderate economic policies. We believe, however, that Mitterrand will be able to point to enough progress on the economic front, especially in reducing the trade deficit, to deflect the pressures to ease up on the austerity program. In particular, the government's efforts to limit progressively nominal wage increases as a means of reducing inflation are likely to generate resistance. [ ]

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#### Political Tactics

The political benefits of sticking with the austerity program are compelling. The Socialists' sights are set squarely on the 1986 legislative elections, as they have been since embarking on their program to reverse the damage done by their initial economic policy decisions. They have a breathing space of at least a year before political necessity will force them to consider reflationary measures. On the other hand, it is essential for them to hold the political center in 1986. Their chances of doing so are slim if they are open to charges of economic incompetence. In our judgment, Mitterrand's strong, if belated, personal support for the austerity program and its ratification at the Socialist Party congress also indicate that a reconsideration is unlikely during 1984. [ ]

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Mitterrand and the Socialists clearly are focusing on the need to win back moderate voters before the legislative elections. To do this, they are:

- Emphasizing their determination to manage the economy soundly.
- Promising to lower the tax burden in 1985.
- Admitting the mistakes of the government's first year—attributing them to overenthusiasm and unwarranted optimism.
- Stating publicly that some cherished leftist concepts, such as class warfare, have scant contemporary validity.

Mitterrand's leftist constituency will not be forgotten, but it is not likely to be favored until the election is much nearer. With the Socialist Party at least nominally united behind a policy of moderation until the next congress in late 1985, and with the PCF likely to be called more strictly to heel if it intends to stay in the government, we believe Mitterrand has relative freedom to concentrate on the moderates.

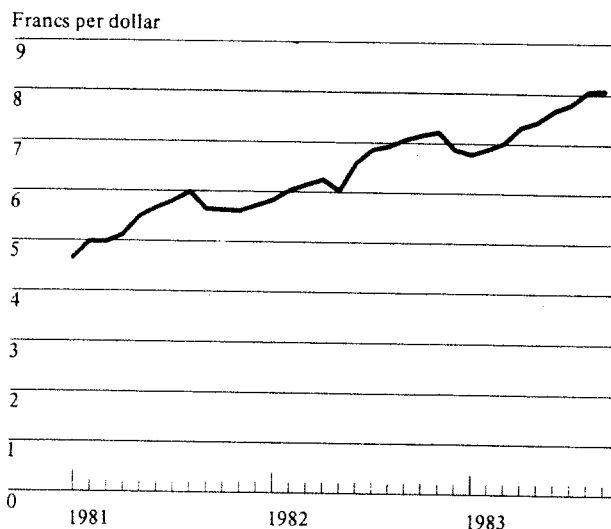
#### Economic Tactics

There is no sign of any weakening in the government's determination to stay the course. According to press and Embassy reporting, the 1984 budget continues the tightening trend begun in June 1982 and reinforced in March 1983. In contrast with earlier budgets, this one projects no growth in overall real government spending. Moreover, it assumes an average inflation rate of 6.3 percent, which is at least 1 percentage point too low. This implies a decline in real terms if spending targets are met. Taxes have again been raised to respect Mitterrand's directive to limit the central government budget deficit to 3 percent of GDP and to make up an anticipated shortfall in social security fund revenues. The government's overall share of national income, which was 42.7 percent when Mitterrand took office, is estimated at 45 percent in 1983. It will rise, according to Embassy reporting, to 46 percent in 1984.

The government's stated goals for 1983—to limit consumer price inflation (measured from December to December) to 8.4 percent and to halve the trade deficit—were too optimistic. Subsequently, the target for the trade deficit was shifted to the end of the first quarter of 1984—four quarters after implementation of the March austerity measures rather than three.

**Figure 3**

#### France: Franc-Dollar Exchange Rates



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We believe that the adjusted target will be met, and perhaps even bettered, even though the stronger-than-expected dollar has been a complicating factor (see figure 3). As was intended, the economy has lost much of its buoyancy; imports have flattened out while French exports, benefiting from previous devaluations and stronger growth elsewhere, have been increasing. Through the first 10 months of 1983, the trade deficit was running at an annual rate of nearly 50 billion francs, compared with 93 billion francs in 1982.<sup>2</sup> It is likely to continue to improve during 1984 and probably will be close to balance before the year ends.

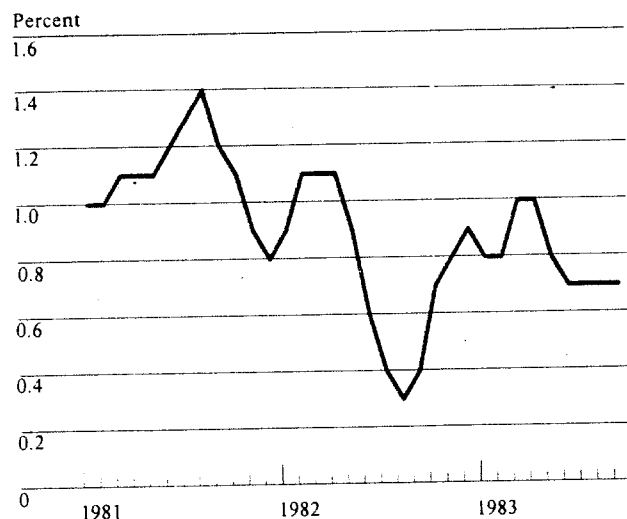
The outlook for inflation is more problematical. Prices have already risen 8.5 percent for the first 10 months of 1983 (see figure 4). The government wants to hold wage increases in 1984 to 5 percent, the same as the

<sup>2</sup> Comparison of dollar equivalents to the French trade deficits is misleading because of the successive devaluations of the franc and the strong appreciation of the dollar against European currencies.

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**Figure 4**  
**France: Consumer Price Inflation<sup>a</sup>**



<sup>a</sup> Percent change over previous month using 3-month moving average.

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projected consumer price rise from December-through-December. To win labor agreement, the government must come close to its 1983 inflation target of 8.4 percent. Workers, and their unions, will be less inclined to go along with an "unrealistic" goal for 1984 if the 1983 target is exceeded by too much. We believe, however, that December-through-December inflation this year will be at least 9.4 percent—a full percentage point above the target.

This disappointing performance may be enough to force the government to give some ground on wages, but we do not believe that Mitterrand will back down in any significant way. The government might, for example, accept private-sector settlements closer to 6 percent than to 5 percent, and it might grant civil servants a modest "catchup" for lost 1983 purchasing power when this matter comes up for discussion in February. We do not believe, on the other hand, that Mitterrand will countenance a return to past indexation practices. Press reporting indicates, to the contrary, that the government may propose that next

year's programed wage increases be semiannual rather than quarterly. It also may propose that only part of a worker's salary—perhaps roughly equivalent to the minimum wage—benefit from a purchasing power "guarantee."

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The government will have some strong advantages as it negotiates with the labor unions. Despite its unsatisfactory—from the labor point of view—performance on maintaining real wages, union leaders still generally believe that a government of the left is likely to serve working-class interests better than the more conservative opposition parties. They may find it necessary to tolerate some displays of militancy, but they will probably try to ensure that any strikes do not push the government too far. The government, for its part, will not hesitate to threaten another wage freeze if labor shows itself to be too inflexible. Not least, rising unemployment, although an additional source of discontent, may also dampen the enthusiasm of workers for a severe, disruptive confrontation with the government.

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Another devaluation of the franc within the EMS is, in our view, inevitable—the inflation differential with Bonn remains too great—but the government will probably try to carry it out "quietly" before speculative pressures require significant expenditures of foreign exchange. Paris undoubtedly will also look to Bonn to bear the lion's share of the readjustment of parities in order to mute opposition criticism.

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The government inevitably will do what it can to balance bad news such as a fourth devaluation and rising unemployment. We expect that it will make much of the good news that is likely to surface—for example, monthly trade surpluses or low monthly price increases. It is also possible that the government will seek to repay some of the country's foreign debt as a highly visible demonstration that its policies are working.

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### Longer Term Prospects and Problems

The Mitterrand government's most severe internal and external critics give it little credit for steadfastness of purpose. They dismiss the austerity program as a tactical maneuver, and they assume that over the longer term it will be compromised out of existence under the pressures of leftist currents. They foresee a reversion to strongly expansionist fiscal policies and wholesale interference in the economy, with the inevitable consequences of inflation, capital flight, labor unrest, and falling competitiveness. The most apocalyptic critics, many representing the French and international financial communities, have foreseen a permanent decline from the ranks of leading industrial powers and a prolonged period of internal unrest. We believe these fears are exaggerated. [ ]

### Likely Policies Through 1985

The Mitterrand government appears to be on the road to repairing the cyclical damage its initial errors caused the French economy. In addition, we believe that the shift toward austerity and the concentration of economic policy making authority in the hands of moderates like Delors and Fabius signifies that Mitterrand's own conception of what a Socialist-dominated government can and should do has undergone considerable revision since 1981. Although Mitterrand has certainly not abandoned his vision of a "different" France, we believe that he and the majority of Socialists now realize that his vision must be more carefully pursued if the left is to retain the support of the French electorate. [ ]

Nonetheless, we believe that pressure will begin to build in 1985 for an economic program somewhat better attuned to the constituency on the left. In addition to the normal risk that a democratic government is likely to expect if the domestic economy is sluggish on election day, the Mitterrand government will need to persuade leftist voters who are now "demobilized" that there is a reason to show up at the polls. It will probably look for ways to display its commitment to traditional Socialist principles that are not excessively costly—for example, honoring the Socialist Party's long-term goal of instituting some form of proportional representation. Another step we believe Mitterrand may take is to replace Mauroy and reshuffle the cabinet to give the impression that the government is taking a fresh look at its policies. [ ]

Some reflationary economic measures are also likely to be taken, but these probably will be held within narrow limits. We believe that Mitterrand will want to avoid pushing the economy's growth too much because overshooting would risk triggering another recurrence of the "go-stop" cycle that caused so much trouble in 1981 and 1982. The level of growth possible in 1985 and 1986 will also depend on the strength of the recovery in France's major trading partners, since Mitterrand's economic policy makers are also likely to calculate that French activity must be restrained somewhat if a repetition of the import boom of 1981 and 1982 is to be avoided. [ ]

### After the 1986 Elections

Even if Mitterrand succeeds in keeping relatively on course up to the next election, he would, during his last two years as President, be left with three, interrelated longer term problems: (1) reducing the burden of servicing foreign debt, (2) stabilizing the franc, and (3) making French industry more competitive in the world economy. Logic and necessity dictate continued moderate policies to deal with these problems, but the outcome here is less certain because political will is as much an ingredient as is economic policy. [ ]

**Foreign Debt.** Gross external debt continued to rise in 1983, but the rapid pace of 1981 and 1982 slowed somewhat with improving trade performance. Although Paris has foreign claims equal to all but \$10-15 billion of its gross debt, many of these claims are on Third World countries whose ability to repay is questionable. Mitterrand must hope that worldwide economic conditions will improve sufficiently to permit French earnings on such services as engineering and public works to take off again, and he must accept the political risk of restraining domestic demand so as to prolong the improvement in the merchandise trade balance and permit the debt to be stabilized and progressively pared down. [ ]

We believe it likely that Mitterrand sees no practical alternative to this course of action. If he does not persevere and accept generally lower domestic growth for a protracted period, the government could eventually be compelled to borrow from the International

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Monetary Fund and perhaps, later, to ask for a rescheduling. This step would be a blow to national pride and would, we believe, demonstrate irrevocably to many Frenchmen the failure of the Socialists' management of the economy. The damage to the party's political prospects would be severe and long lasting. [ ]

**Stabilizing the Franc.** The problems of the franc also demonstrate the need for a longer term commitment to austerity. Each devaluation increases the cost in francs of imports and of servicing the external debt. In the long run, a stronger currency would limit imported inflation and make servicing the debt less burdensome. Success in stabilizing the franc will depend, in large measure, on making French industry more competitive in world markets so that it need depend less on devaluations for trading advantage. A stronger franc would also be, in a sense, a byproduct of the austerity program's goal of cyclical economic stability. [ ]

**Improving Competitiveness.** The competitive problem of French industry has been developing for some time. Burdened with high nonwage labor costs, higher than average domestic inflation, and constant government reluctance to permit reductions in the work force, French businesses have too often found their goods overpriced abroad. The Mitterrand government's initial policies made the problem worse, and the austerity program, with its higher taxes and pressure on domestic prices and profit margins, has done little to stabilize the situation. [ ]

After their initial skepticism about the weak financial position of French business, Mitterrand and the Socialists have undergone a change of attitude. Mitterrand, for example, fired Chevenement partly because the former Industry Minister's activism led him to become too involved in the day-to-day management of nationalized firms. Mitterrand now admonishes that bureaucratic meddling in the affairs of those firms must be avoided. Since taking over from Chevenement, Fabius has publicly taken the position that the government must be more flexible in its attitude toward corporate decisions on rationalizing facilities and reducing the work force. He has stressed that the

government must try to shift more of the sizable budgetary resources it commits to industry away from propping up lameduck enterprises. [ ]

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We believe that Mitterrand is sincere in wanting to reduce the cost of doing business for French enterprises and to increase their share of national income so they can undertake necessary modernization. We are less certain, however, that the government will be able to develop a coherent strategy for achieving the goal. Mitterrand and the Socialists have not abandoned their concept of an industrial policy led by the public sector as the key to future success in domestic and foreign markets. Such a program requires a substantial commitment of money by the government. Although the new sense of realism we detect probably means that industrial policy goals and means will be assessed more carefully in the future—and that the needs of the private sector will figure more prominently in the government's calculations—we believe that a clash over resources is likely. To make more funds available to the private sector, the government will need to content itself with less. The result will probably be a compromise in which neither the public nor the private sector will be satisfied. As a result, French competitiveness is not likely to be revived as quickly or as fully as the government hopes. [ ]

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### Implications for the United States

Because France under Mitterrand has been a strong advocate of maintaining the military balance in Europe and shares the US goal of opposing Soviet and radical Third World expansionism in the Middle East and Africa, US interests call for a strong and stable France. On balance, we believe that Mitterrand's current economic program works toward this goal by reversing policies that, if continued, would have turned France inward and led to the country's pauperization. The Socialist Party's evolution toward economic pragmatism, if it is maintained, will contribute to political stability in France by establishing the

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party as a moderate democratic alternative on the left. Although the political price of the economic lessons the Socialists have had to learn has been, and will continue to be, a heavy one, at the present time we find little evidence that social unrest will reach levels sufficient to threaten the government's stability or to force Mitterrand to abandon his course. French commentators, including some associated with the political opposition, generally do not foresee an explosion of the kind that occurred in 1968. [REDACTED]

The United States also has an economic stake in the success of Mitterrand's current policies. His rejection of the leftist "alternative" reduces the threat of a major increase in French protectionism. In addition, the recent favorable trend toward balance in the trade account has made tougher measures to reduce imports less likely. On the other hand, we do not expect the use of administrative impediments to imports to diminish, since the government will continue to look for ways to "accentuate" the good results. Paris is also likely to continue to push the EC to follow a tougher line against third-country imports. US agricultural products may be particularly affected. [REDACTED]

If Mitterrand's policies fail—or if the Socialists reverse themselves and revert to irresponsibly expansionist policies—there are potentially serious negative consequences for the United States. One result would be the triumph of Chevenement and the other leftist advocates of the alternative course founded on nationalist self-assertion. This would inevitably give rise to a new wave of protectionism. In its wake would come disruption of France's economic ties to the United States and its other major Western trading partners. Ultimately, France's contribution to Western security could be affected as a progressively poorer France began to lose its ability to maintain the present level of military expenditures. [REDACTED]

Even before this stage was reached, a serious failure of Mitterrand's policies would probably lead to a proliferation of frictions in US-French bilateral relations. It is highly likely that a beleaguered Mitterrand government would try to blame its woes on a foreign scapegoat. The United States—whose policies the French have frequently blamed for the problems of the world economy—would be a strong candidate for this role. Under these circumstances, Franco-US cooperation in pursuit of common goals would become significantly more difficult and problematical. [REDACTED]

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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

French Thoughts on High Technology Trade and Related IssuesSummary

High technology industrial development is a priority for the Socialists that is supported across a wide spectrum of the policymaking establishment. Trade in high-tech products and processes is a relatively new concern, and the positions of major players are not yet well developed and even less well documented. We conjecture that the position of most groups would be based on an "infant industry" argument that new French producers need help in some form until they can compete with the Americans and Japanese. Given the current concerns of the major policymakers, they may be receptive now to an "effective protection" argument, which emphasizes the need of French firms to import high-technology products in order to modernize and to become more competitive. An argument based on projected growth in major markets may induce the French to make trade concessions necessary to gain access to the more rapidly growing areas. Like their predecessors, the current policymakers will be more receptive to pragmatic arguments for freer trade than to Anglo-Saxon free-trade doctrine or theory.

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This memorandum was prepared for Geza Feketekuty, Senior Assistant, US Trade Representative by [redacted] Western Europe Division, Office of European Analysis, Central Mediterranean Branch. Questions and comments may be referred to [redacted] Chief, Western Europe Division [redacted]

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### Fundamental Approaches

The original approach of the Socialists to French industry was summarized by the "filiere" (network) concept, which emphasized the development of integrated production networks, beginning with the raw material stage and running through the finished product. This approach, which dominated official French thinking during the first 18 months of the Mitterrand government, is associated primarily with Jean-Pierre Chevenement, the former Minister of Industry and the leader of the Socialist Party's left wing. It was influenced in large part by French perceptions of MITI's success in Japan. [ ]

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A corollary to the "filiere" approach, at least for Chevenement and other Socialist supporters of the concept, is that large nationalized enterprises would be best able to accomplish this mission. Although French protectionism in its most transparent forms probably was not part of the original "vision," successive governments in Paris have used both Common Market trade barriers and the many forms of state "dirigisme" to their advantage. [ ]

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By contrast, the so-called "creneau" (niche) concept aims at finding and developing specific competitive areas or lines in which to develop French industrial capabilities. In contrast to the "filiere" approach, it recognizes the advantages of specializing within industries and the growing importance of intra-industry trade. The Pompidou and Giscard governments generally followed the "creneau" approach. [ ]

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### Pragmatic Constraints

These ideas and perhaps an underestimation of French potential and accomplishments probably still characterize the thinking of many Socialists. However, both the unfortunate consequences of early macroeconomic policy and the experience of dealing with the problems of the French economy for two years has induced a more pragmatic, realistic, and modest approach among the major economic policymakers. [ ]

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President Mitterrand, under the tutelage of Finance Minister Delors and new Industry Minister Fabius, is beginning to recognize the limits to what the government can do in support of industry. He has acknowledged that if France is to improve its economic prospects, initiative on the part of enterprises, entrepreneurs, and firms must be encouraged. In Mitterrand's words, "The initiative of entrepreneurs, industrialists, and those who create new firms is decisive ... it is not civil servants who make the economy." In other statements, Mitterrand has referred to getting the government "off people's backs," and has said that the government should only "set the grand outline of economic and industrial strategy." [ ]

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Mitterrand and Fabius also have indicated in more specific ways the importance of small and medium-sized firms. Both have been impressed with the speed and the nature of the American recovery, in particular with the part small and medium-size firms are playing in it. Fabius was impressed with his visit to Silicon Valley in 1982 and the emergence of the many and varied small firms there. Mitterrand has put Silicon Valley on the itinerary for his visit next month. [ ]

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Along with recognizing the limits of what government can do for industry and the importance of entrepreneurship and flexibility in both small and large enterprises, most French policymakers now emphasize the need for profitability and reduced charges and burdens on industry. In an almost Lafferesque statement, President Mitterrand has stated that "too many taxes kill tax revenue." There are even indications that major policymakers have realized that administrative measures reducing a firm's freedom to make labor force decisions also reduce its willingness to expand or take other risks. Other types of bureaucratic obstacles have the same effect. [ ]

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### Pro-Trade Arguments

Although the creation of high-tech industry remains a Socialist priority, their concerns recently have centered more on job creation and the modernization of French industry. The Mitterrand government initially required that foreign investment in technological facilities generate technology transfer. The present preoccupations of French economic policymakers suggest they now may be more open to arguments for freer trade in high-tech products and processes. Reminders that import barriers increase domestic producer costs, slow modernization and job creation, and reduce French international competitiveness could be effective. Such arguments would at least put some of the issues in a context that emphasizes French concerns and interest. [ ]

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The French are now entering a recession while the rest of the world is beginning to recover. Having been burned once, the French will be very careful about expanding more rapidly than their major trade partners. Most economic policymakers in France seem resolved to maintain austerity for at least another year. INSEE, the French Statistical and Economic Institute, foresees at least five years of relatively slow growth for the French economy. [ ]

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The traditional increase in protectionist pressure in times of slow growth may be at least partially offset in the French case by the out-of-phase nature of France's recession. With markets for French goods likely to grow more rapidly over the next five to ten years than the French market for imports, the French might be receptive to reminders that protectionism, by encouraging retaliation, could exclude them from rapidly growing foreign markets when French demand is weak. They might realize that during an important period for developing market shares in new products it might be costly to take the time to develop whole production chains rather than draw on all possible sources to increase their productivity in areas where they have an advantage. Reciprocity, in terms of market access, may appeal to the French if they are among the slower growing economies. [ ]

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### The Players

The views expressed by Fabius, Delors, and recently by Mitterrand suggest that pragmatic arguments for free trade in high technology may receive a receptive hearing. Edmund Malinvaud (INSEE), Claude Milleron (Prevision), Michel Rocard (Socialist rival to Mitterrand and Minister of Agriculture), and Francois-Xavier Strasse (Elysee economics adviser and writer under the name Jacques Gallus) all have the reputation of being more pro-trade oriented. Jean-Jacques Servan-Schreiber, though not a Socialist, is an adviser to

Mitterrand and has disagreed strongly with the nationalism and protectionism of Chevenement and the left-wing Socialists. Among those close to the President, Pierre Berégovoy has protectionist leanings; Jacques Attali has made protectionist-sounding statements in the past but has also argued strongly against the "Chevenement option." [redacted]

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Pressures on Mitterrand from outside his administration are not well focused. Labor unions, for example, find their strength concentrated in the traditional industries where their main concern is job preservation. If high-tech trade is seen to reduce employment by speeding the modernization of industry through automation or new production techniques, the unions will object. They also are likely to object if high-tech imports are seen to displace production that would take place domestically using union members. These concerns are currently too nebulous to carry much weight, however, and labor unions have little influence in new growth industries such as biotechnology. [redacted]

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We have little solid information on the current thinking of such key opposition players as Valéry Giscard d'Estaing, Raymond Barre, and Jacques Chirac. Objectively, they all should see the advantages of trade. Their experience with nuclear energy, arms production, and the Airbus will have informed them of the importance of imported technology; the Concorde experience has made them cautious of politically motivated production programs; and during their terms in government, they all spoke of the limitations of nationalized industry, the importance of small and medium-sized firms, and the necessity of private innovation. Nonetheless, their record on issues such as export credits, targeting, and industrial subsidization indicates they are far from being free-traders. We suspect Chirac, who has been away from hard national economic issues for several years, may be a bit more merchantilist than Barre or Giscard. [redacted]

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#### The EC Option

Developing a Common Market technology initiative appeals to the French. They hope to develop a market for French technological output that will allow them to realize necessary economies of scale while remaining somewhat sheltered from the full force of American and Japanese competition. At the same time, they hope that EC producers can become more competitive in world markets by uniting their resources. The French probably hope that they would be the major Community player if they succeed in this strategy. [redacted]

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Fabius is scheduled to meet with his European counterparts in late February. He has indicated that he will push the "ESPRIT" program, which is an effort to develop a joint research and development program, concentrating on electronics. He recognizes the reluctance of several other member countries. He has indicated he will also push for similar joint efforts in biotechnology. [redacted]

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The EC option is probably better for the French than an autarchic approach. Nonetheless, the arguments that the French would be putting barriers in front of their own firms by erecting trade barriers is still valid. If joint ventures within the Common Market are encouraged by reducing the

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possibility of forming alliances with American or Japanese firms, European firms will be disadvantaged in world markets. [REDACTED]

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If economies of scale and distribution networks in high-tech goods encourage joint ventures, then American and Japanese firms may seek partners. If the Europeans are not receptive, they may force the Japanese and Americans to become allies. The suggestion of a de facto Pacific Basin alliance in high-tech production may persuade the French to reconsider any strong EC protectionist policy. [REDACTED]

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### Conclusion

The French do not have a strong free trade tradition and will be influenced more by their own interests than by abstract Anglo-Saxon doctrine such as the "international division of labor." The French might be persuaded to reduce barriers to trade that limit their access to the most up-to-date technology, but they are likely to resist commitments that would severely limit their ability to use non-trade initiatives to obtain their ambitious goals for French high-technology industry. [REDACTED]

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23 February 1984

## MEMORANDUM

French Goals in Lebanon

The French are primarily concerned with preserving the Lebanese state and their own credibility in the Middle East.

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The French want to remove the bulk of their remaining forces (about 1,350 men) from Beirut, but do not want to risk compromising their substantial interests in the region with precipitous action. Their decision on Tuesday to shift Embassy personnel to less exposed locations probably does not presage a large-scale evacuation. Even if Paris decides to lower its profile -- by returning troops to France or diverting them to the 1,380-man French contingent with UNIFIL in southern Lebanon -- we believe a minimum of a few hundred soldiers would stay in Beirut to protect some 4,000 French nationals living there.

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The French continue to promote a UN force in Beirut to replace the MNF. In the French view, however, such a force could not be expected to restore order but would serve essentially to police a pre-existing truce among the warring parties. Although Paris has been willing to meet some of the initial Soviet demands regarding the composition and deployment of a UN force, we believe it will continue to reject Soviet preconditions that MNF countries withdraw their fleets far from the Lebanese coast and pledge non-interference in Lebanese affairs. President Mitterrand's personal aversion to accepting Soviet preconditions probably is reinforced by more general French concern that any perceived surrender to Soviet demands would wreck French credibility with Arab partners -- especially Saudi Arabia, Egypt and Iraq -- damage relations with the United States and hurt the government domestically.

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The French see several advantages in reaffirming their independence from the United States by pursuing their own diplomatic efforts. They have heard criticisms of US policy from their Arab partners and clearly would like to appear more reliable and even-handed. Although wary of Soviet and Syrian motives, the French see some indications of flexibility in their positions and may believe that they can better encourage it on their own than in cooperation with the United States. Given the significant loss of French lives in Beirut, Paris also is worried that close identification with the United States would heighten the already substantial risks of extremist -- particularly Iranian-

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[redacted]  
backed -- attacks on the French contingent. [redacted]

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Over the longer term, the French see their independent stance as possibly contributing to a general settlement in the Middle East. Mitterrand probably believes France (with West European backing) is better situated than the United States to encourage moderation within the Arab world -- including the Palestinians -- and possibly to gain some measure of Soviet acceptance of an overall settlement. Traditional French interest in using political influence to obtain commercial advantages in the Middle East certainly plays an important role as well, but probably is not the determining factor in Mitterrand's calculations. [redacted]

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At the same time, the French acknowledge limits on their influence as well as a need for cooperation with the United States. For example, although Mitterrand remains more favorably disposed toward Israel than former President Giscard or even many of his senior advisers, he evidently believes that only the United States could eventually convince Israel to offer territorial concessions and flexibility on the Palestinian issue as part of an overall settlement. [redacted]

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MEMORANDUM FOR THE RECORD

The attached memorandum summarizes the key points of French foreign policy decisionmaking and the role of important French officials involved in issues of concern to the United States.

The memorandum responds to a request from NSC staffer for Western Europe, Ty Cobb, who intends to use this material to prepare the President for the visit of French President Mitterrand, 21-28 March.

EUR M 84-10043

Date 2 March 1984

FORM 101 USE PREVIOUS EDITIONS

## MEMORANDUM

French Foreign Policy Decisionmaking

The Constitution and traditions of the Fifth Republic grant the President a relatively free hand in foreign and defense affairs. He is Commander-in-Chief of the armed forces and has the power to commit French forces to combat without prior notification of -- or ex post facto authorization from -- Parliament. Under Article 16, he can assume near dictatorial powers if the "institutions of the Republic, (France's) national independence, territorial integrity, or ability to fulfill its international obligations are seriously and immediately threatened." President Mitterrand has followed his predecessors' example by concentrating policy formulation and decisionmaking within a small group of presidential advisers. [redacted]

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Formal Structures

The responsibilities for individual ministries are established by law and amended by government decrees. Interministerial coordinating committees -- for example, on arms sales -- often are headed by a representative of the Prime Minister, who can arbitrate contentious decisions or forward the problem to the Elysee. Although the cabinet occasionally issues statements on foreign and defense subjects, little discussion on such matters actually takes place at weekly cabinet meetings. Like his predecessors, Mitterrand limits formal consideration of these topics to a "restricted council" which includes the Prime Minister and Ministers of Defense, External Relations, and Interior. This excludes the four cabinet-level Communist appointees. [redacted]

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The Socialists promised in 1981 to increase the role of the National Assembly and the Senate in foreign policy deliberations, but little substantive change has taken place. Parliamentary committees on defense and foreign affairs -- particularly those in the Socialist-dominated National Assembly -- receive only general briefings on government policies and expenditures. Senators and deputies have neither the access to government data nor the staffs to analyze it on anything like the scale of the United States Congress. Foreign and defense policy debates in both chambers can be heated, but they usually conform to pre-determined party lines and have little impact on government decisions. [redacted]

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Elysee Dominance

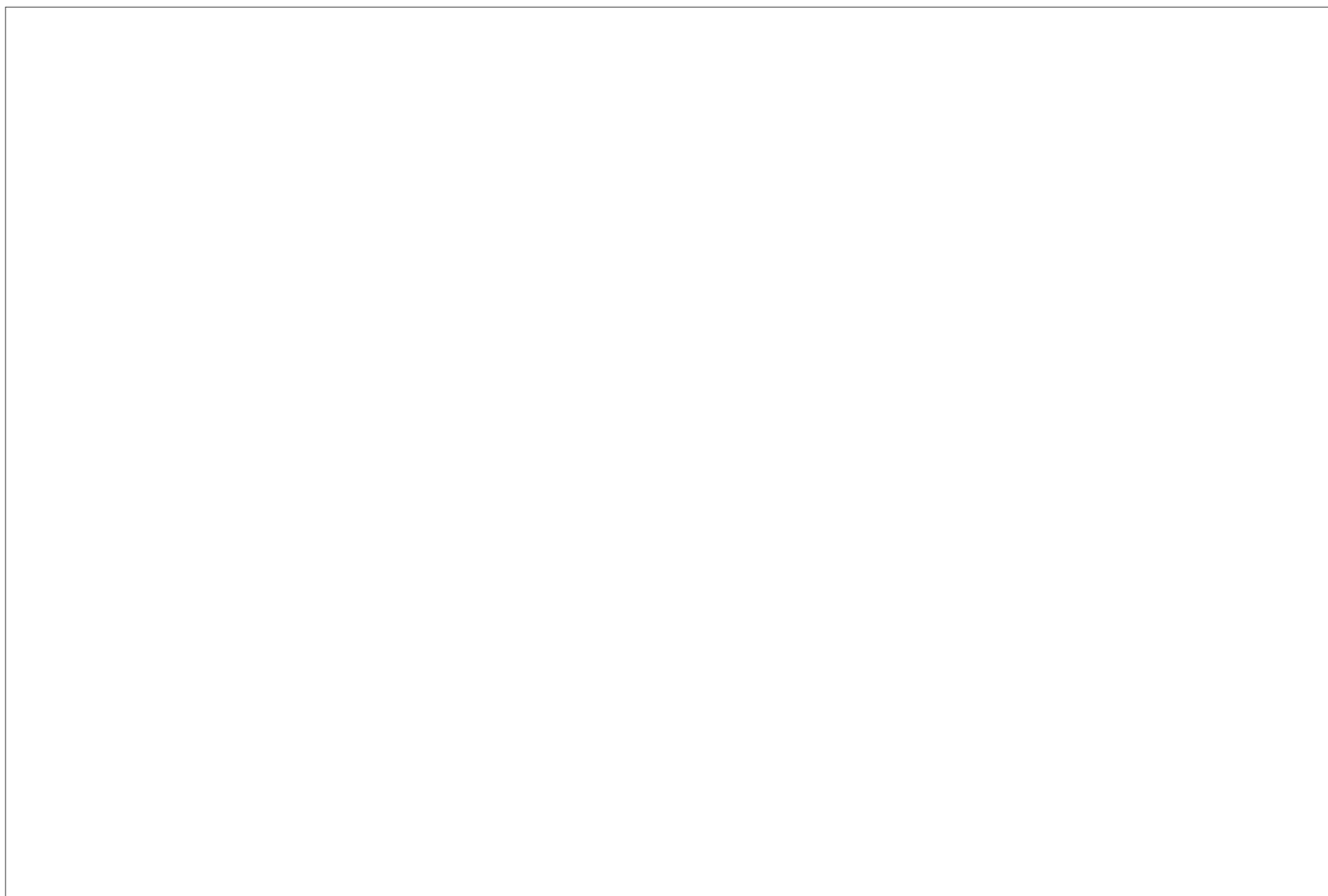
The Gaullist concept of foreign and defense affairs as the "special domain" ("domaine réservé") of the presidency has been adopted and even expanded by Mitterrand. Having originally focused his personal attention on relations with the United States, the Soviet Union, West Germany, and Africa, the President now takes a direct hand in relations with the Arab world, Israel, the European Community, and even Latin America. [redacted]

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## France: Options on Austerity

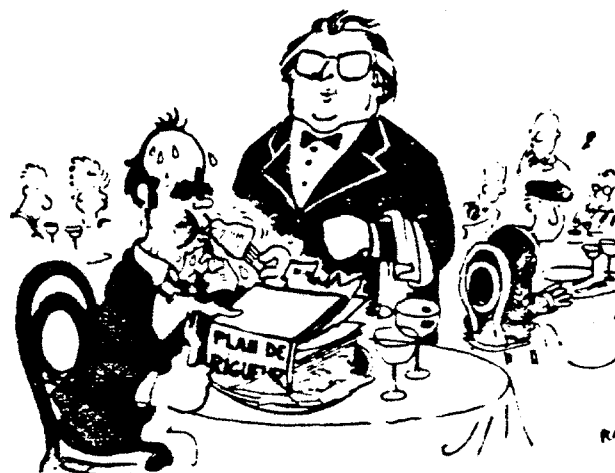
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Despite rising labor resistance, the French Government appears determined to give industrial modernization and the battle against inflation priority in 1984. Continuing such policies beyond early 1985, as may be warranted by economic conditions, will be politically risky for President Francois Mitterrand and is likely to cost Mitterrand's coalition support from the left in the 1986 legislative elections. He thus may attempt to shift his political base toward the center.

## Austerity—The First Fruits

Rising inflation and a soaring current account deficit forced the Mitterrand government to abandon expansionary policies and shift to austerity in 1982. This shift was reinforced last March with a new austerity package and the ouster of a leftist spokesman in a cabinet reshuffle. These changes signaled a smaller role for the government in the daily running of the economy and an increased recognition of the cost of supporting sick industries. The government now acknowledges the need for profitability, even at the cost of cutting back work forces. The decision in late 1983 to allow Peugeot to reduce its work force by nearly 2,000 workers—despite strong union opposition—was the first significant indication the government was willing to allow some loss of jobs in order to promote modernization.

The austerity measures adopted by the Socialist government over the past 18 months have yielded mixed results. The trade deficit last year was about \$6 billion compared with \$14 billion in 1982. The current account improved by \$8 billion last year as well but still recorded a \$4 billion deficit. At the same time, prices, measured from December to December, rose 9.3 percent, well above the 8-percent target. Real GDP recorded only a slight increase last year—after growing by 2 percent in



French Prime Minister Pierre Mauroy serves up the austerity plan to Georges Marchais, the head of the Communist Party.

Le Monde ©

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1982—and probably will not do better in 1984. Consumption spending fell in the third quarter of 1983 and may continue to decline through the first half of 1984. Exports, which have expanded rapidly since the devaluation in March 1983, probably will again be the major source of any growth.

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## Austerity—Continuing in 1984

Having made some progress thus far, the government seems fully committed to continuing austerity for another year:

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- The 1984 budget maintains about the same degree of austerity as the March 1983 package, but the money-supply target (M2) has been cut by 3 percentage points to only 6 percent.
- Price controls are scheduled to be eased only as inflation slows. The government hopes that price controls, wage guidelines, and a tough position in

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3 February 1984

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negotiations with government workers will hold down wage increases.

- Paris hopes to slow inflation to 5 percent this year, which would be the lowest rate since 1970.
- The government expects progress on the foreign payments front to continue and hopes the current account will achieve a surplus in 1985—perhaps \$6-7 billion—in order to reduce France's medium- and long-term foreign debt, which now totals \$53 billion. [ ]

The improvement in trade and current account balances may allow Paris to delay another devaluation of the franc, which many forecasters had predicted for this spring. The continuing strength of the dollar, though much maligned by the French, also will reduce the probability of a franc-mark realignment in the near term. Stronger growth among the other industrial countries bodes well for the foreign balances and the franc for the first half of the year. [ ]

On the other hand, French inflation probably will continue to exceed that of most competitor countries in 1984, hurting French competitiveness. In addition, reduced OPEC income and LDC debt problems have weakened demand for French products in traditionally strong markets. Moreover, interest payments on France's foreign debt will be higher this year. Given these factors, Paris is not ready to declare victory on the foreign payments front. [ ]

We believe the most agonizing challenge the French will face this year will be the management of structural change. The government could be called on to authorize a quarter of a million layoffs in 1984; job losses are likely to be particularly serious in coal, steel, shipbuilding, and textiles. Mitterrand's leftist coalition will find this ideologically and politically difficult and will be vulnerable to attacks by labor and the Communists. [ ]

### Austerity—When Will It End?

In our judgement, the French will not fully achieve their economic objectives in 1984. We expect the French to exceed their 1984 inflation target by 2 to 3 percentage points and to have one of the highest inflation rates among the major industrial countries. Although the current account is likely to improve through 1984, the anticipated 1985 surplus will not be sufficient to allow a rapid reduction in French debt. The structural problems of the French economy will remain, and unemployment could rise about 0.5 percentage point to 9.5 percent by year-end. [ ]

By early 1985, even with austerity goals only partially achieved, the Socialists will turn their attention toward the National Assembly elections scheduled in the spring of 1986. Conventional wisdom and previous Socialist strategy statements indicate that the Socialists will feel obliged to stimulate the economy to improve their bleak election prospects. The Mitterrand government knows such a reversal would be risky for the economy. The previous Socialist expansion program in 1981-82 caused a rapid increase in imports and only a modest improvement in domestic conditions. Mitterrand and his advisers are painfully aware how rapidly the current account can deteriorate and the franc weaken and thus may consider an alternative policy. [ ]

### Political Implications

President Mitterrand has basically three options:

- To move to the right and continue austerity through 1985 and perhaps beyond, accepting an increase in unemployment as the cost of modernization.
- To maintain the current policy of austerity for this year and then stimulate the economy in 1985 in the hope that an upturn will help Socialist candidates.

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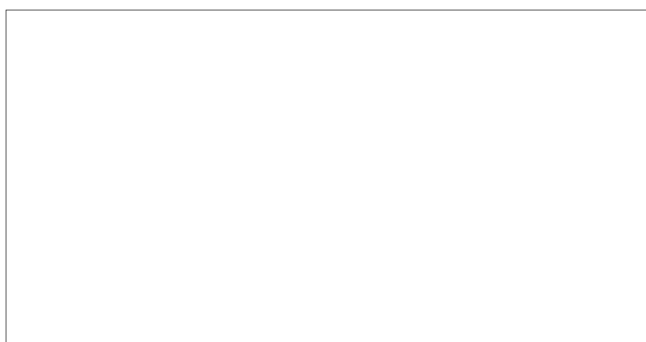
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3 February 1984

- To swing to the left and adopt Communist and leftwing Socialist proposals to head off rising unemployment with immediate stimulative and protectionist measures—an alternative he has already rejected twice. [redacted]

Mitterrand appears to be leaning toward the first option. In recent speeches both he and his loyal lieutenant, Laurent Fabius, the Minister of Industry and Research, have stressed the importance of pressing ahead with modernization. The government's handling of the Peugeot strike suggests that Mitterrand is willing to accept the political risks of reducing the number of workers in the troubled smokestack industries. [redacted]



Mitterrand probably hopes that political gains in the center will compensate for the likelihood that the left will lose its legislative majority in 1986. By restoring economic health and showing that modernization holds future promise, he will be in a position to court support from centrist voters who were crucial to his victory in 1981 but who are now disenchanted with the government's economic management. Such a move to the center may be part of a broader strategy, suggested by several French political commentators, in which Mitterrand might propose a system of proportional representation to strengthen centrist parties prior to the 1986 elections. [redacted]

A move to the center and the continuation of austerity are not without risks. Mitterrand's uneasy alliance with the Communists almost certainly would end. The break could occur through Mitterrand's forcing them out of the Cabinet if they refuse to support his policies, or the Communists

could leave on their own and attempt to portray themselves as the "true" defenders of labor. The Socialists could end up as an isolated minority if the leftist coalition breaks up before Mitterrand cements his ties to the center. Rising protests against austerity, however, might become so strong that he would be forced to abandon the policy before it achieved its goals. [redacted]

There will be a number of signposts in 1984 that will indicate whether Mitterrand has indeed decided to attempt a shift toward the center. The first will be the determination with which the government pursues its goal of modernization and its willingness to accept the dismissal of large numbers of workers in sectors such as coal, steel, and shipbuilding. Next will be the nature of the Cabinet shakeup that is widely anticipated in the second half of 1984. Prime Minister Pierre Mauroy, who is closely identified with the policy of protecting jobs, may be replaced, and the political coloration of his successor will say much about the government's intentions. A Cabinet shuffle could also provide the occasion for a showdown with the Communists. Finally, the 1985 budget, which will be introduced next autumn, will indicate the intensity with which Mitterrand has decided to continue with austerity. [redacted]



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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

5 March 1984

European Defense Cooperation: The WEU Initiative [redacted]

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Summary

The West European Allies are becoming increasingly interested in coordinating their defense policies. They feel a need both to distance themselves from the US after the public furor over INF deployments and to gain greater influence within the Alliance. In addition, they want to encourage joint production projects in the defense sector to boost their sluggish economies and to offset the large US trade advantage in this area. France is attempting to capitalize on these sentiments by resurrecting its old scheme to use a "revitalized" Western European Union as a major vehicle for European defense cooperation; Paris has asked for a meeting of the WEU Council at the ministerial level on 24 May to discuss this approach. West Germany, Belgium, Italy, and Luxembourg are interested in the idea, but the United Kingdom and the Netherlands are skeptical. It is unlikely that all seven members will agree on how to strengthen the WEU, or, indeed, on whether they should take this approach at all. All WEU members, however, appear willing to hold a special meeting of defense ministers in Rome next October to mark the 30th anniversary of the organization's creation, and they might agree to additional meetings of WEU defense ministers. If such meetings occur, and particularly if they become regularized, they could give the defense ministers' collective voice more weight in NATO and encourage greater collaboration in the defense sector. [redacted]

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This memorandum was prepared by [redacted]  
[redacted] the Office of European Analysis. Questions and  
comments may be addressed to [redacted] the European  
Issues Division [redacted]

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Background

The West European members of NATO, with varying degrees of enthusiasm, have sought since the late 1970s to increase coordination of security policy and cooperation in the development, production, and acquisition of arms and military equipment. Recently, West European interest has gained a new urgency. Two factors underlie this development:

- The INF basing controversy heightened the West German government's feeling that it must show that it is not completely subservient to US defense policymakers, as its critics have charged. The West Germans especially, but most of the other West European allies as well, periodically have felt that the US does not pay enough attention to their concerns on foreign and defense policy. Many of them believe that as a result of the INF basing controversy it is time for them to be more assertive in these areas.
- At the same time, the continued economic slump in Western Europe caused governments to focus on what they see as the failure of the US to meet its commitment to the "two-way street" in defense procurement. They have long felt that the US has an excessively large advantage in intra-Alliance arms trade (see table).

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Balance of Trade in Defense Equipment With WEU Members, FY 1982  
(Ratio of US Exports/US Imports as of February 1983)

<u>Country</u>	<u>FY82</u>	<u>77-82</u>
Belgium	7.6:1	7.8:1
France	2.3:1	5.9:1
FRG	5.9:1	13.4:1
Italy	10.4:1	16.4:1
Netherlands	10.8:1	9.7:1
UK	3:1	3:1

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As these other forces were building, it became clearer than ever that the EC political cooperation mechanism could not be an effective forum for increased defense cooperation. The French, Danes, Irish, and the UK remained opposed to formalized EC discussion of security issues, an idea pushed by West German Foreign Minister Genscher and Belgian Foreign Minister Tindemans. Moreover, on other foreign policy issues EC members were having less and less success reconciling competing interests to reach common political positions. [redacted]

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### The French WEU Initiative

Perceiving the strength of the sentiments brewing in Western Europe, the French dusted off an idea they have promoted periodically since the 1960s: revitalizing the Western European Union as a forum for defense cooperation (see appendix). According to press reports, France has invited the foreign ministers of the other WEU members to discuss defense cooperation at a special meeting on 24 May. The WEU forum offers the French certain advantages:

- It is headquartered in Paris.
- It is not too closely related to NATO, and yet it is authorized by treaty to address European defense matters in cooperation with NATO.
- It is more easily influenced by France since, unlike NATO, the US is not a member and, unlike the EC, it has no supranational apparatus.
- It allows Paris an additional opportunity to influence West German technical military development through discussions on defense cooperation.
- Its membership is limited to the six original EC members and the UK, and thus it comes close to being the "exclusive club" that France has traditionally favored for defense cooperation.
- Similarly, since the WEU excludes the West European nations with the least developed defense industries, France believes it would be an appropriate forum for discussing increased cooperation in arms production. [redacted]

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Recent French initiatives to revamp the WEU reflect a growing consensus--within both the French government and the broader non-Communist political elite--that French security interests dictate increased European cooperation on strategy and

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weapons coproduction. President Mitterrand is particularly eager to ensure Bonn stays tied to the West. [REDACTED]

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Given their concerns about the Soviet military build-up in recent years, the French fear that a weakened West Germany would leave them dangerously exposed to Soviet pressures. Significantly, in an effort to counteract this trend, Paris supports the removal of most WEU restrictions on West German conventional forces and defense industries, except for nuclear, chemical, and biological weapons. [REDACTED]

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[REDACTED]

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The French are proceeding cautiously because they are aware that their WEU initiative could appear to be a challenge to NATO at a time when the French themselves are interested in somewhat greater participation in the Alliance. According to our Mission to NATO, French defense officials have expressed great interest in increased participation in Allied discussions on emerging technologies and technology transfer, and have voiced fear that French lack of participation in NATO's integrated military structure may hamper Paris' interests in this area. [REDACTED]

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[REDACTED] Paris evidently prefers to reach a better understanding among its European partners before broaching the subject with the US. [REDACTED]

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[REDACTED]

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West Germany

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Bonn has reacted positively to the French initiative.

In part, Bonn's interest has been aroused by the possibility that WEU armaments restrictions might be lifted. Such a move would have little economic or military importance--the most objectionable restrictions have already been rescinded--but its political symbolism would be significant for Bonn. It would be a sign of West European confidence in West Germany, and in the Kohl government in particular. It would also show solidarity between Bonn and other European capitals in the defense area at a time when the SPD and some elements of the West German public have questioned the Kohl government's independence from the US.

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There are more practical reasons why Bonn is responding positively to France's idea of strengthening the WEU. It sees expanded coproduction schemes with its European allies as offsetting what it perceives as a disappointing record of US procurement of West German-produced weapons and equipment. Hence, West Germany is eager to develop its own cooperative programs. The West Germans recently agreed with France to develop an antitank helicopter, and they have joined France, the UK, Spain, and Italy to develop common requirements for a European combat aircraft. Despite Bonn's interest in using the WEU to enhance policy coordination on armaments programs, we believe the German government would view the Independent European Program Group (IEPG)\* as the preferred forum for addressing these

\*The Independent European Program Group (IEPG) was formed in the mid-1970s. Participants include all members of NATO's Eurogroup--Belgium, Denmark, West Germany, Greece, Italy, Luxembourg, the Netherlands, Norway, Portugal, Turkey and the UK--plus France. This independent organization is currently the principal mechanism for promoting military equipment cooperation among European Allies, and to foster closer and more balanced arms cooperation with the US and Canada. Upper-level defense officials currently are overseeing 24 programs that are in various stages of development and operational use. Chairmanship of the IEPG rotates among the members biennially.

problems on a technical level. The IEPG has proved successful in the past, and Bonn would prefer to exploit its achievements rather than go through the burden of developing a new structure. [redacted]

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Bonn also likes the idea of increased cooperation with Paris in order to draw French military forces closer to NATO. Additionally, West Germany has long sought to gather information on French nuclear plans and policies. Expanding the WEU would open another avenue for gaining this information. [redacted]

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Despite its apparent interest in strengthening the WEU, Bonn insists that discussion of European defense questions be conducted within a NATO context. West German Foreign Office officials acknowledge that the WEU could be a useful forum for discussing security issues, but they insist that any revitalization of the WEU should have the purpose of supporting NATO rather than providing an alternative to it. [redacted]

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#### UK

London appears satisfied with the current level of European defense cooperation--bilateral and NATO consultations and occasional discussions in the EC's political cooperation framework. [redacted]

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The British are probably aware that especially Paris and possibly Bonn see potential political benefits for themselves from a strengthened WEU, but the political gains for London are less readily apparent. The British have traditionally opposed formalizing West European political cooperation, being well aware of the potential for misunderstanding with Washington. The Thatcher government would, in addition, have particular problems with upgrading WEU. [redacted]

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Italy

Rome has been doing much of the legwork for Paris in promoting a revitalized WEU, primarily because it fears exclusion from deliberations among its larger West European partners. For example, Italy often complains that it is left out of routine talks among the UK, West Germany and the US on MBFR. An enhanced WEU, in addition to helping Rome foster the illusion that it is on an equal footing with the more important Allies, could somewhat increase Italian influence on West European and NATO

\*The Eurogroup is an informal association of defense ministers of West European NATO members within the framework of the Alliance. Eurogroup was founded in 1968 to give European members of NATO a forum to discuss all aspects of defense policy. Current members include Belgium, Denmark, West Germany, Greece, Italy, Luxembourg, the Netherlands, Norway, Portugal, Turkey, and the UK. Spain is not yet a member.

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security concerns. Italy also believes that greater West European cooperation on defense production and procurement, especially regarding new conventional weapons, could help alter its unfavorable trade balance with the US in the defense sector. [redacted]

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### Benelux Countries

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Belgian officials in the past have been receptive in principle to French aspirations for the WEU. Moreover, Belgian officials recently have complained about exclusion of Belgium from the trilateral meetings on MBFR and Belgium's continued adverse trade balance with the US in defense equipment. [redacted]

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Although Belgian officials say the government is divided on WEU revitalization, Tindemans is very enthusiastic, and has exchanged views with Genscher on the subject. Tindemans' concept of a future WEU, however, is quite different from that of the French. He is a fervent "European" who has been one of the staunchest supporters of institutionalizing political cooperation within the EC. [redacted]

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## Outlook

West European interest in increased defense cooperation will remain high, but there are formidable obstacles to a genuine revitalization of WEU:

- Wariness of the UK and the Netherlands; particularly significant is the British dislike of formalized discussions on foreign policy.
- West European concern over how the US will react, particularly given the importance that some WEU members--the UK and the Netherlands especially, but also Italy and West Germany--attach to more extensive NATO consultations on such issues as strategic defense and modernization of conventional weapons.
- The exclusion of other members of NATO from consultations on security issues. [redacted]

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The WEU meeting in October probably will occur and be limited to defense ministers; the UK and the Netherlands are likely to balk at a simultaneous meeting of foreign ministers. The October meeting could be followed by other meetings of defense ministers, which we believe would be kept occasional and informal. The UK and the Netherlands would probably insist on this; the French, Germans, and Italians--who may prefer more regular and formal sessions--would probably go along in order to gain agreement. [redacted]

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High-level meetings of this sort, even if not formalized, could provide the political impetus to greater coordination of defense policy and cooperation in arms procurement. In this event, and especially if such meetings occurred on a regular basis, the defense ministers' collective voice would have more weight in NATO discussions. But this political impetus would then need to be translated into joint policies and programs. The bureaucracy to do this does not now exist in the WEU, and we believe there would be powerful opposition to building it. Other organizations might be pressed into service to help WEU defense ministers implement policies and programs. But all of these organizations have larger memberships than WEU and are problematic in other ways. For example:

- The EC political cooperation mechanism could conceivably be used to prepare for, and follow up on, ministerial level discussions of defense policy; but EC members have had only limited success with political cooperation, and several Community members are opposed to EC involvement in defense issues.

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- The Eurogroup could support meetings of European defense ministers, but the French do not belong, and the organization is too closely related to NATO for their taste.
- In the area of arms production and procurement, the Independent European Program Group could effectively do the behind the scenes work for defense ministers; but even in this case, the IEPG's membership is larger than that of the WEU and it is not a forum for discussion of the political aspects of arms policy. [REDACTED]

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Despite these obstacles, West European interest in increased defense cooperation is now more intense than at any time since the 1950s. A number of factors will have a bearing on whether this new enthusiasm grows stronger: the state of East-West relations, the perceived willingness of the US to consult with its Allies on a broad range of mutual security concerns, and the economic situation--not to mention the reaction of the US to its Allies' expressed aims for the WEU and for increased defense cooperation in general. [REDACTED]

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APPENDIX: The WEU

The Western European Union was established when the signatories of the 1948 Brussels Treaty--the UK, France and the Benelux States--revised the treaty to include Italy and West Germany. In accordance with the Paris Agreements of 23 October 1954, the Brussels Treaty Organization was renamed and constituted as the Western European Union by four protocols. Protocol III prohibits West Germany from manufacturing nuclear, chemical, or biological weapons, and certain types of missiles. In addition, the West German Bundeswehr is limited to no more than 500,000 men. Furthermore, the WEU determines the amounts of major weapons and ammunition that may be stockpiled in West Germany. Many of the original, more objectional WEU restrictions, such as the limits on submarine construction, have been rescinded. [REDACTED]

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The WEU was used by its members from 1967 to 1973 as a forum to discuss foreign policies before the UK joined the EC and during a time when France would not address issues outside the community's competence in the EC. The WEU ceased to be the focus of political cooperation when the UK joined the EC in 1973 and EC members decided to hold such discussions informally. [REDACTED]

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The primary function of the WEU is the coordination of defense policy and equipment. Its structure consists of:

- The Council of foreign ministers or ambassadors, based in London, which formulates policy and issues directives to WEU agencies in "cooperation" with NATO.
- The Agency for the Control of Armaments, based in Paris, which monitors the production of armaments and stocks of armaments to ensure that certain types of arms are not produced.
- The Standing Armaments Committee, based in Paris, which is charged with fostering close cooperation between members on arms development and production.
- The Secretariat, based in Paris, which implements Council directives.
- The Assembly, which meets twice a year in Paris, and is comprised of delegates of the member countries to the Council of Europe's Parliamentary Assembly. It debates defense policy and adopts recommendations to send to the Council, national parliaments, member governments, and other international organizations. [REDACTED]

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